



City of Detroit

OFFICE OF THE AUDITOR GENERAL
COLEMAN A. YOUNG MUNICIPAL CENTER
2 WOODWARD AVENUE, SUITE 208
DETROIT, MICHIGAN 48226
PHONE: (313) 224-3101
FAX: (313) 224-4091
WWW.CI.DETROIT.MI.US

Joseph L. Harris, CPA, CIA
Auditor General

Sharon L. Gipson, CPA
Deputy Auditor General

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Honorable City Council
Detroit, Michigan

Good morning

Today, I will provide your honorable body three documents: *The Auditor General's Audit of the Mayor's Proposed Budget for 2005 – 2006*; *The Auditor General's Five-Year Forecast for 2005 – 2010*; and *An Actuarial Analysis of the City's Retiree Health Care and Pension Benefits*.

I will begin my remarks by briefly responding to some of the Mayor's comments from his budget address to you last week.

The budget I present today is the result of months of in-depth review of both the services performed by every city department and the revenue sources that provide the funds to pay for those services.

This budget was not done overnight, or in a few weeks or even months. Rather, it incorporates more than 18 months of work coordinated by the Strategic Management Center (SMC), which has conducted aggressive research and strategically looked at the City's structure both vertically and horizontally.

Undoubtedly the eighteen months were very grueling, considering the financial challenges confronting our City government. Although it is possible, it is highly unlikely that if the Administration had another eighteen months, it would have been able to complete the task it began, i.e., to provide your honorable body with a realistic financial plan for next year.

When I took office in 2002 we were handed a growing deficit of \$75 million dollars. We were able to close that gap.

The City spent the last three years closing budgetary gaps by issuing bonds. During the past two years, the City floated long-term bonds to cover short-term costs. Now that the City has used its credit to the maximum, it must finally face its structural deficit head-on.

The City's deficits began with the budget for the fiscal year ended in 2003. The borrowing doubled each year as the true deficit increased each year.

Borrowing, as a quick fix to plug budget gaps, may be feasible when the gaps are cyclical. However, the City's budget gaps are **structural**, i.e., they are not going to go away by themselves. As reflected in our Five Year Forecast and our actuarial study, which we will provide shortly, the City's structural deficit will continue to grow until the City addresses it.



We also have cut more than 3,000 positions from city government.

Hundreds of the positions cut from City government were vacant, and have been for years. To proclaim the accomplishment of cutting vacant positions is a stretch. Moreover, some of the positions that were cut were essential positions cut without regard to their importance, and without consulting with the respective agencies. Jobs such as police cadets, DDOT personnel, 36th District Court, safety officers, and Risk Management Council staff appear to have been indiscriminately terminated.

In recent months we've heard some sniping in the media about how this tough budget should have been done years ago. The question is, how many years ago? One? Two? Five? Ten?

Three!

Hindsight, as the saying goes, is always 20-20. The fact is we all need to move forward from this day on. We have oncoming traffic ahead of us and it's coming fast. The City of Detroit, Wayne County, the Detroit Public Schools, the Big Three, the State of Michigan, all are facing financial challenges. Looking in the rearview mirror wastes time and is, quite frankly, dangerous when we need to keep our eye on the road ahead to respond to that oncoming traffic.

If we do not reflect on our failures, and the causes of our failures, we are destined to continue to make the same mistakes. Tunnel vision and myopia have gotten us to where we are. If we do not look far ahead, around us, and behind us, we will not have all of the data required to make sound decisions.

A careful review of the facts shows we have been balancing and re-balancing our budget since we took office. We have done it in a way that attempts to preserve as many services, and as many employee jobs, as we possibly can.

The City should **not** have been attempting to preserve as many employee jobs as possible. That mentality is a major contributor to the City's deficit spending during the past three years.

We didn't come in with a meat ax and just start cutting departments indiscriminately. We've reviewed each operation and achieved efficiencies on a department-by-department basis.

Usually there were no reviews of the departmental operations. In several cases, the departments were not consulted and had no prior knowledge of the planned cuts. In many cases, no efficiencies were effected. Rather, many departmental functions were often arbitrarily and capriciously discontinued, some which imposed severe hardships on many citizens, and others at the risk of incurring fines and penalties resulting from not meeting legal mandates.

This budget involves a fundamental restructuring and reengineering of City government to be fully implemented and completed in the new budget year.

Reengineering of a department, even one division of one department, moreover, even one process takes several months, if not years. To assert that City government can be reengineered fully within one year is categorically absurd. If it could be done that quickly, it would have been done long before now. Reengineering is not synonymous with reorganization. Reengineering requires the fundamental rethinking and radical redesign of business processes. We have not even begun the benchmarking required to identify the processes and best practices the City should consider adopting.



This budget creates a new form of city government that will dramatically reduce costs and improve the quality of services for all citizens through four types of cost savings strategies including business process reengineering, consolidation of existing departments, spin-off operations, and divestiture or discontinuation of services.

Although the concept is sound, conceptually, unfortunately it is merely rhetoric. There has been no planning or coordination of the concept. No business process reengineering has taken place, nor has any planning for the proposed spin-offs, divestitures, or discontinuations taken place. This crisis management is the direct result of the City's failure to recognize and plan for these inevitable circumstances.

It is a different budget than has ever been presented to our city council.

(comment withheld)

Every budget is based on a series of *assumptions*, based on our experience and our goals. This budget is no exception. It contains a number of measured *assumptions*. The first of these *assumptions* involves a renegotiation of our health care contracts with City employees.

The additional cost for each employee is approximately \$3,000 annually. Whether the employee bargaining units would agree to these additional assessments, in addition to the proposed 10 percent pay cuts, is problematical.

This budget also *assumes* we will be able to reach agreement with our employee bargaining units to achieve a 10 percent pay cut through a total of 26 days without pay, or as they are commonly known, DOWOPs.

The budget assumes such an agreement for all employee bargaining units, effective July 1. None of the unions, to date, have indicated any willingness to agree to these measures

This budget also *assumes* that we will adopt two new sources of revenue in Detroit, a fast food tax and a property transfer tax. Both will require approval of city voters. The fast food tax would apply only to fast food restaurants. The property transfer tax will apply to the sale of property in the city and will be assessed as a part of the closing costs. Together, they will raise roughly \$15 million in the coming fiscal year.

First, the mayor plans to increase taxes on the highest taxed community in the state. Second, the chance of this increased tax being approved by the State legislature is slim. Third, the chance of this increased tax being approved by the voters is slimmer still.

The management of the Detroit Department of Transportation (will be transferred) to the Detroit Area Regional Transit Authority (DARTA).

Although the plan for DARTA is the "regionalization" of the tri-county area bus system, the DARTA bus system has not been organized, and the transfer of the DDOT has not been negotiated and agreed upon by the other stakeholders.



In the police Department, we are suspending the existing classes at the academy and will reduce the number of commanders and inspectors. (Also) the budget eliminates 47 EMS positions.

The City used this type of impulsive reasoning, which can be characterized as crisis management, when it conceived a plan to discontinue 24-hour bus service.

This budget that I present to you involved months of hard work that resulted in making tough and smart decisions that will put us on the path to building a new Detroit.

According to the book *The Price of Government*, "A budget is really just a forecast, a statement of **expected** revenues and expenses. If done right it can be a serviceable estimate. But in the end, every budget is based on assumptions, and you can make it better or worse simply by changing those assumptions." (Emphasis added)

As we will show, the Mayor's proposed budget included approximately \$300 million of questionable or unattainable revenue increases and expenditure reductions.

If the City is to develop a meaningful budget, it is evident that it will have to be developed by the City Council.

It is noteworthy that no plans have been made to incorporate the **structural** changes recommended by the Auditor General to fix the Department of Transportation or the Law Department's Workers Compensation Division, or to upgrade the City's telecommunications network, or to reduce the City's risk management costs, or to modernize the Public Lighting Department's Mistersky plant – recommendations amounting to savings of over \$50 million annually. Rather than electing to radically redesign our business processes to achieve dramatic improvements in our costs, and our quality of service, we have elected to attempt to raise our exorbitantly high taxes and to cut, not improve, City services.

Claims against the City exceed \$50 million per year. Instead of creating a Risk Management Officer who would be responsible for minimizing these claims against the City, the Mayor has reduced the Risk Management Council's staff from four auditors to one, and has eliminated two safety officers from the proposed budget. He also underfunded the Risk Management Fund (self-insurance fund) by \$12.5 million.

MAJOR ISSUES CONFRONTING CITY GOVERNMENT

The cost of living in Detroit, considering the high-cost of insurance and the high taxes imposed on its citizens, cannot be justified by the quality of the services the City provides. Meanwhile, while residents are abandoning the City at a rate of about 1,500 per month during the past year, the City is attempting to raise taxes on those who remain, rather than attempting to ease the tax burden.

Many citizens are fed up with Detroit's failure to provide them with basic, friendly, dependable, cost competitive City services.

The City's problems have been exacerbated by the City's growing structural deficit, which has been virtually ignored until recently due to the influx of Casino revenues about five years ago. However, as we will show, the structural issues, much like a cancer, are insidious, and their effects will be devastating if they are not addressed.



If this legislative body cannot make the tough decisions, and if the labor unions do not agree to the required concessions to keep this City from default, the City's only hope is the intervention of a professional team that makes business decisions unfettered by cognitive biases and political & personal relationships.

City Council

The failure of the Mayor to establish his credibility and to cooperate with City Council has been extremely detrimental to City government. The City's myriad of problems cannot all be attributed to the Mayor, however. Although this Administration has made innumerable mistakes, some members of City Council have contributed consistently and significantly to the chasms.

This City Council has been, in my opinion, one of the most divisive and ineffective legislative bodies of this City within the past several decades. In my opinion, some council members consistently obscure, delay, and/or impede progress for political expediency.

Some are more interested in radical, divisive, racist concepts, such as African Town, a race based community, which would not only be detrimental to both the image of the City and the direction in which this City needs to proceed, it is contrary to the desires of most African Americans. The creation of a ghetto is an anathema that represents a return to what many African Americans have attempted to escape. It sends a message to outsiders, both potential residents and businesses that this is a government that supports racism ... not all small businesses, not all Detroit-based businesses, not all Detroit resident, not all poor people, but only members of a particular ethnic group. Moreover, the book (*PowerNomics*), from which the concept emanated, is fraught with fallacious, impractical ideas. The concept is not only undesirable, it is unworkable. It is not based on sound economic theory, or on some concept that has been successfully practiced elsewhere. It is purely conjectural. Those who blindly follow the author's lead not only do not understand the socioeconomic impracticalities of the plan if implemented, but moreover, do not understand the ramifications of such a government-sponsored plan. There is no place in this world for such a racist-based philosophy, regardless of the race that prescribes them. The only ones that can benefit from this book are the author and the publisher.

While the City should be welcoming all people of all ethnic groups to live and establish businesses in the City, some council members disdain members of ethnic groups that conduct business in the City. Most are not competing with African American businesses, but rather are providing goods or services that, otherwise, would be unavailable in those communities, while maintaining their property and acting as good neighbors and good corporate citizens. Nevertheless, they are chastised as a group by some council members, effectively impairing opportunities for a rebirth of this once great city.

Politics

Organizational and political factors have caused Detroit to fail to avoid its current financial predicament. We did not gather or act on information about known problems.

City officials, who have been in denial about problems, were setting the City up for disaster. What is happening to the City of Detroit is a replay of a theme that has occurred in many industries over the past fifty years.



Consider the destruction of commercial fisheries – a problem that started in the northeast United States and is now starting around the globe. Areas that seemed to hold unlimited supplies of fish saw their stocks dry up. It was totally predictable.

Species of fish had diminished due to frenzied harvesting. Too many fishermen were hunting down a finite supply of fish ... a modern reenactment of the near extinction of the buffalo.

There were many warnings about what was taking place. Biologists regularly notified governments, including those in the U.S. that various species faced depletion. Governments, as is their habit, initially ignored the warnings. Eventually, they accepted the data and proposed limitations on fishing. But, then the fisheries lobbied against such action.

With their incomes declining, they wanted more fishing, not less. Finally faced with dramatic declines in the fish population, governments took decisive action. But by then, it was too late because the fisheries, which had won the political battle, lost their livelihoods.

What is true of people who fish for a living is true for people who work in government.

Their individual short-term interests can overwhelm the collective good. It is almost as if people admit, yes, something must be done, but not yet and, certainly, not by us.

The City cannot afford the continuation of well-meaning public policies that, in the long-run are contrary to the public good, such as preferred treatment to Detroit-based businesses that costs the City millions of dollars that cannot be financially supported

The City's current dilemma is not the result of a lack of information by City Officials.

The five year forecast I provided Your Honorable Body two years ago, Mayor Archer's ten year forecast provided to you five years ago, both pointed to the current financial crisis.

The City's current dilemma is a direct result of the City's incentive failures whereby City officials had actionable insights about predictable surprises, but lacked the incentives to forestall them.

In politics, special interest groups dominate the landscapes. The problem is that such groups define their own interests narrowly with a fixation on the short-term, and the political support they receive aggravates the problem and accelerates the arrival of financial and operational conflicts.

The Auditor General's recommendations have lost out to the desires of groups of individuals who have their own, selfish interests in mind, and consequently are both blinded by their own biases and are unwilling to accept the facts when presented to them.

There are only two ways out of the City's current debacle: draconian concession by the labor unions, or receivership. Unless the unions accept the reality of the City's financial quagmire, and accept the concessions that will be required for the City to achieve financial viability, they will lose half their members that are funded by the General Fund, including public safety employees. That is the harsh reality of our predicament.



Moreover, unless the unions accept the reality of the City's financial quagmire, unless City officials make the decisions that are necessary to keep Detroit afloat, a receivership will not only be the outcome, it will be preferable to the dysfunctional government to which our citizens are being subjected.

Political self-interests, and short-term orientations too often outweigh far-sighted decisions. What may seem to be the right thing to do politically, may be the wrong move. Think of America's steel workers who resisted concessions, the fisheries who resisted reform, and what is now happening to the United Automobile Workers (UAW).

Labor Unions

No mayor and no council alone can fix our broken government. Unless the labor unions accept the reality of the predicament, and agree to drastic concessions, the City's fate is sealed. To illustrate this point, consider the following:

"Birmingham, Alabama has become the factory capital for a growing number of car manufacturers, parts suppliers and businesses that flocked to the Deep South within the past ten years...Manufacturers are taking full advantage of a southern workforce eager for the kind of well paying, challenging jobs that these companies offer, and local and state officials willing to offer packages of incentives. Given how grateful any state would be to secure just one automobile plant, Alabama's success has been truly astounding. Of the five automobile assembly plants that were up for grabs in recent years, Alabama landed three, along with an engine plant built by Toyota. Since 1993, when Mercedes announced it would build its plant in Vance, 35 miles west of Birmingham, Alabama's automobile industry has swelled to include 19,500 people directly, employed by the various auto factories, including the Honda plant in Lincoln, 20 miles east of Birmingham, and the Toyota engine plant in Huntsville, directly north. More jobs will be added when the Hyundai plant, under construction to the south of Montgomery, opens in 2005...another 33,800 people work at automotive components and other companies tied to the industry, while 96,200 jobs have been added indirectly, from hotels, restaurants and other business that have sprung up as a result of the investments...and Alabama officials believe the of investments is far from over."

"...The union hasn't given up its efforts to organize these factories, but it hasn't succeeded at any of the independent factories owned by import auto companies in the United States. The UAW has been defeated in elections at both Honda and Nissan – four times at Nissan alone – and has never called a vote at Toyota, though it has had an organizing office there for years...what keeps the UAW out of these plants...is the fact that workers aren't convinced that a union would make things any better for them.

"...The process of the UAW is what keeps Detroit companies from achieving the efficiency of the transplant factories in "Detroit South" (as Birmingham, Alabama is called) and elsewhere. This obstacle is best defined by a thick book that contains the UAW's master agreement with each company. In it lies definitions of job classifications and staffing requirements across the plants, as well as the holidays, vacation pay, pensions and other benefits that the UAW workers receive. In addition to the master agreement, there are individual contracts for every assembly plant. All these pages add up to additional costs and complexities that the transplants don't have.

"The transplants pay salary rates of about \$25 an hour, which is within range of those earned by a typical worker at GM, Ford, or Chrysler. Generous even by northern standards, the income is enormous for workers in low-wage southern states.



"The infrastructure of the automobile companies has become so heavy, and the burden of health care and pension costs for retirees so great, that there is not enough profit being generated to support them for the long term.

"To blame the union alone for what's happened to the Detroit companies is just plain wrong. Detroit's problems haven't been caused only by the fact that its workers are unionized and those at the transplants are not. There are two signatures on every union contract, one from the UAW, the other from the auto companies.

"The automobile companies have only themselves to blame, for in every instance an auto company agreed to go along.

"What will it take to change that? It will require vision and courage, not just from one side of the table but from both. Until that happens, nothing will change in the master contracts or in the way of thinking that permeates Detroit.

The End of Detroit
By Micheline Maynard

City officials have been aware for over five years of the City's precarious financial condition and yet they continued to negotiate pay raises instead of negotiating concessions. As long as the City could borrow its way out of its deficits, rather than making the required sacrifices, the City's financial dilemma was camouflaged.

The City is now recognizing the manifestation of this structural deficit, which has been festering as an insidious cancer for several years, somewhat masked by Casino revenues over the past five years

The City's financial predicament was first publicized about five years ago by Mayor Archer, when he warned City Council of an impending deficit that would approach a billion dollars within ten years. We have had five years to prepare for the outcome. We have no excuse for being unprepared. The danger signals were there for everyone to see in time to prevent this tragedy from occurring.

Officials should have expected the City's financial crisis, but did not. The warning signs were there – borrowing each year, long term, to cover costs such as insurance premiums pension costs, automobiles, and equipment that previously had been paid out of General Fund revenues. They saw downward trending income tax revenues, state revenue sharing revenues, and inflation adjusted utility users tax revenues, declining population of both residents and businesses, combined with increased salaries and wages, pension costs, healthcare costs, and insurance premiums. But City officials ignored or glossed over the signs. That is, they failed to fulfill their leadership responsibilities.

City leaders continued to pay excessively for goods and services to Detroit-based businesses – and, in one instance last year, a half-million dollars more than the low bidder.

First, leaders knew a problem existed that wouldn't solve itself. Second, they knew the problem was getting worse not better. Third, because solving the problem would impose significant sacrifices immediately, officials decided to solve the problem later. Fourth, the presence of vocal groups that benefited from inaction was, clearly, a contributing factor.



Several years ago, the City underwent a benchmarking study, which identified hundreds of millions of dollars of potential savings. To date, almost nothing has been done to remotely pursue any of the potential opportunities expressed.

As you know, I have been advocating the preparation of five-year forecasts and related strategic plans for several years. Had City government officials developed budgets beyond one year, along with plans to address the projected shortfalls, this crisis could have been forestalled. The five-year forecast I prepared for the City two years ago was ignored.

THE SOLUTION

Strategic Planning

As I have stated annually, without a plan, the City is "flying blind."

Labor Unions

As discussed earlier in this message, the City's crisis cannot be averted without the cooperation of the labor unions.

Rightsizing

Detroit needs to clear the decks, i.e., we need to eliminate functions and policies that don't contribute to the City's mission and core goals. We need to abandon them, sell them, or move them to a different provider.

Managed Competition

"The fastest way to save money and increase value is to force public institutions to compete. Nobody who doesn't own one thinks monopoly is good for business. Why should it be any different in the public sector?"

The Price of Government

David Osborne and Peter Hutchinson

Former Indianapolis mayor, Stephen Goldsmith, who was initially an advocate of privatization wrote the following, six months after running for mayor on a privatization platform. "Contrary to their undeserved poor public image most civil servants are hard-working and talented, and they know a lot more about how to do their jobs well than mayors or union presidents. The problem is that workers historically have been trapped in a system that punishes initiatives, ignores efficiency, and rewards big spenders."

Detroit needs to adopt the policy of managed competition. However, it would be an injustice to the City workers to expect them to compete when led by poorly trained or uninspired managers, and restricted by inadequate training, tools and equipment.

Also, before the City can make a comparison of its costs against the competition, it must first determine how much it actually costs the City to perform the function, whether its filling potholes, collecting garbage, or operating a bus line. The solution is activity-based costing (ABC), an accounting techniques that has been used in the private sector for years. ABC can also be used to implement gainsharing, whereby employees are allowed to take home some of the savings they generate. Like profit sharing in the private sector, it can have an enormous impact on employees' behavior.

Managed Competition makes potential providers of government services – whether private firms or public agencies – compete against others to win government work. The contests create economic or psychological incentives that stimulate performance.



Accountability

Until City officials hold agencies and individuals accountable for well-defined outcomes, the City will continue to be an inefficient and unreliable provider of basic City services.

The City needs to seriously implement performance measurements – not a close facsimile of performance measures as we now have, but a system that creates information about the results of public activities in order to hold individuals and organizations accountable, and to introduce consequences for performance. It helps citizens and customers to judge the value of the services provided by government, and it provides managers and employees with the data they need to improve their performance.

Talent

The City needs to assemble a talented management team.

Running an effective transportation system is not rocket science. But we don't know how. Preparing accurate and timely financial statements is not impossible. But we don't know how. Minimizing claims paid by the City is not difficult. But we don't know how. Ridding the City of structural deficits can be done. But we don't know how. Operating our City effectively on a \$1.4 billion budget is not unreasonable. We just don't know how.

The Budget

City Council controls the purse strings. It controls the budget; and it controls the approval of contracts. If the administration proposes to spend \$500,000 more on a contract than on a competing contract for identical services, it is incumbent upon the City Council to reject the Administration's proposal ... not endorse it.

Oddly, the Mayor reduced the OAG staff by one-third for the current year, and is proposing a cut of one-half of the remaining staff in his proposed budget. These cuts will effectively disable the City's internal audit function.

The Office of the Auditor General has conducted investigations which have identified over \$10 million in fraudulent transactions within the past several years. It has also recommended over \$50 million in annual savings, \$40 million from DDOT alone.

The Mayor also, inexplicably, severely reduced the staff of the Finance Department, which has had extreme difficulty producing the City's financial statements on a timely basis, in its already decimated condition.

The Mayor plans to severely reduce the staffing for the 36th District Court by reducing the City's appropriations to the Court by over \$10 million – an amount the Court cannot absorb. Moreover, the cuts came as a complete surprise to the Court, which was expecting a \$2.5 million cut. The cuts to the Court appear incongruous considering the full funding of the Strategic Management Center, which the Mayor credits for developing this budget, the Program Management Office, and the Museum of African American History. These decisions are reflective of the priorities the Administration has set during his tenure. For example, the annual financial statements for the fiscal year ended June 30, 2004 will finally be issued this month, ten months after the end of the fiscal year. The Mayor proposes to reduce the staffing of the Finance Department by several additional people next year. Moreover, his proposed budget does not include sufficient funding to pay the outside auditors to opine on the City's June 30, 2005 financial statements.



If the Administration proposes an unreasonable budget, it is City Council's responsibility to reject the Administration's proposed budget and to pass a responsible budget. Failure to do so is a failure of the legislative branch.

Lansing and Wall Street will be watching this council's actions closely. Failure by this body to satisfactorily develop a plan to address the anticipated shortfalls may be your last opportunity to do so for several years because your failure will prove that our elected officials are incapable of governing this city.

Thank you for inviting me to share my thoughts with you. Although this City will little note, nor long remember what I say here today, the importance of the issues in this message cannot be overstated.

It's in your hands.

Respectfully Submitted

Joseph L. Harris